

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 02-0094  
GROSS, ADJUSTED GROSS AND  
SUPPLEMENTAL NET INCOME TAX  
FOR THE YEARS 1996 THROUGH 1999**

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**ISSUES**

**I. Income Tax – Unrelated Business Income Tax**

**Authority:** IC § 6-8.1-3-1(a); IC § 6-8.1-1-1; IC § 6-8.1-5-1(a); IC § 6-8.1-5-1(b); 45 IAC 15-2-1; 45 IAC 15-5-1.

Taxpayer protests the Department's assessment of Gross, Adjusted gross, and Supplemental Net Income Tax.

**II. Tax Administration – Penalty**

**Authority:** IC 6-8.1-10; 45 IAC 15-11-2

**STATEMENT OF FACTS**

Taxpayer was incorporated as a not-for-profit entity on January 19, 1962. Taxpayer received a Federal determination letter from the IRS granting it tax exempt status on September 29, 1969 and again on January 17, 2002. The taxpayer never received tax exempt status from the Department. The taxpayer was created to own real property because the parent organization by-laws do not allow it to own real property. The Department conducted an audit investigation and discovered that the taxpayer held title to the property used by the parent organization, operated the bar with alcohol and food sales, conducted pulltab and punchboard games, and maintained slot machines for use by the parent organization members and their guests. The slot machines viewed by the Department's auditor were cherry masters that dispense five dollar (\$5) winning tickets and the video poker machines pay ten dollars (\$10) for every 200 points. According to the Department's auditor, the bartender pays the winning tickets. The auditor also stated in his report that the taxpayer is not tracking slot machine income and in two instances the bartenders pay has come out of the bingo account.

**I. Income Tax – Unrelated Business Income Tax**

### **DISCUSSION**

Taxpayer, a not-for-profit corporation, received its Federal tax exemption in 1969. However, the taxpayer did not apply for State tax exemption. The taxpayer is also not a qualified organization for charity gaming purposes. Therefore, the income generated from selling pulltabs and punchboards is subject to gross income tax at the high rate. The Department calculated the gross receipts from these games and subtracted the manufacturer's listed pay outs to determine the gross income subject to taxation. The illegal revenue from slot machines was also taxed at the high rate. The taxpayer's income from gaming activities for the years 1996 and 1997 was subjected to gross income tax. For the years 1998 and 1999, the taxpayer's income is subject to adjusted gross income tax. The audit allowed a deduction for the expense of pulltab and tipboard games as determined by the invoices provided by the taxpayer. Other expenses allowed as deductions have been taken from the parent organization federal form 990EZ. The taxpayer and the parent organization filed a 990EZ and combined their records in order to complete the returns. The Department informed the taxpayer that the entities are two separate organizations and they must file separate returns. The taxpayer was also subjected to supplemental net income tax.

Pursuant to IC § 6-8.1-3-1(a), the Department "has the primary responsibility for the administration, collection, and enforcement of the listed taxes," including "the state gross retail and use taxes." (IC § 6-8.1-1-1). Under 45 IAC 15-2-1, the Department was established for the purpose of administering, collecting and enforcing all taxes placed under its authority." Pursuant to IC § 6-8.1-5-1(a), the Department "shall make a proposed assessment of the amount of the unpaid tax" when an audit reveals discovers a failure to collect and remit the tax. *See also*, 45 IAC 15-5-1. Under IC § 6-8.1-5-1(b), the "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with" taxpayer.

The taxpayer has not met his burden of proof in this matter. Taxpayer did not receive tax exempt status from the Department as a not-for-profit; therefore, taxpayer is taxable as a regular corporation.

### **FINDING**

Taxpayer's protest is denied.

## **II. Tax Administration – Penalty**

### **DISCUSSION**

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10. The Indiana Administrative Code at 45 IAC 15-11-2 provides in pertinent part:

- a. "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
- b. The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
  - (1).the nature of the tax involved;
  - (2).judicial precedents set by Indiana courts;
  - (3).judicial precedents established in jurisdictions outside Indiana;
  - (4).published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
  - (5).previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. In this instance taxpayer was negligent in its failure to apply for State tax exempt status and its use of illegal gambling machines and the failure to pay taxes on the receipt of the illegal income is sufficient grounds upon which to impose the negligence penalty.

### **FINDING**

Taxpayer's protest is denied.